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SENSITIVE

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TAGS: EFIN ECON ECIN RP CN XE XD
SUBJECT: Philippines: Holding Up But Pain Increasing

REFS: A) 08 Manila 2532, B) 08 Manila 2725, C) 08 Manila 2740, D) Manila 0108

SENSITIVE BUT UNCLASSIFIED

¶1. (SBU) Summary: The Philippines is unlikely to slip into recession in 2009 (Refs A and B). However, the global financial crisis is inhibiting capital formation, depressing trade, dampening tourism, and eliminating jobs in some sectors. The Philippine Central Bank cut interest rates again in January and the government's budget deficit will increase. The Philippines will weather the crisis better than many of its neighbors, but further reforms are needed to stage and sustain the strong post-crisis recovery required to generate jobs, boost investments, and alleviate poverty (Ref C) -- which remains the focus of U.S. development assistance and policy advocacy here (Ref D). End Summary.

GDP Musters 4.5% Fourth-Quarter 2008 Growth

¶2. (U) Philippine GDP growth slowed to 4.6% in 2008 (a six-year low) from 7.2% in 2007 (a three-decade high). The economy's 4.5% year-on-year expansion during the fourth quarter surpassed most expectations. Personal and government consumption grew 4.5% and 4.7% in real terms, respectively. Construction spending grew at 11.6%. However, weak investments and exports were a drag on economic growth. Fourth-quarter investments in capital equipment and inventories declined by 7.4% and 84.5%, respectively; and combined merchandise and service exports contracted by 7.5% in real terms.

¶3. (SBU) The International Monetary Fund recently reduced its Philippine growth forecast to 2.25% as have a number of credit-rating agencies in line with more pessimistic global economic growth projections. Philippine economic planning officials privately admit that the government may need to review its current 3.7%-4.7% growth target for 2009 in view of increasingly gloomy global economic prospects, but they still expect growth to be higher than the IMF forecast.

Banks' NPL Ratio Lowest Since Asian Crisis

¶4. (U) The Central Bank reported recently that the commercial banking system (which makes up more than 90% of aggregate banking sector resources) recorded a 3.8% non-performing loan ratio as of end-November 2008, the lowest since the ratio peaked at 18.8% in October 1981.

Overseas Deployment Holding, But Prospects Cloudy

¶5. (U) The Philippine Overseas Employment Agency (POEA) reports that overseas deployment of Philippine workers grew nearly 28% to more than 1.3 million during 2008. Fourth-quarter deployment expanded 9.7% year-on-year despite the troubled external environment, supporting the steady flow of remittances that helped prevent a sharper slowdown in domestic demand and overall economic growth. Deployment in January 2009 increased 18% year-on-year. Encouraged by this relative resilience and the nearly 480,000 active job vacancies as of mid-February (more than a quarter for professional, technical and managerial workers), the Agency remains hopeful about reaching its one million annual deployment target in
¶2009. The officials estimated crisis-related overseas job losses at less than 5,500 thus far out of the more than four million Filipino contract workers abroad, with nearly 80% of the lost jobs representing retrenchments by electronics and export manufacturing firms in Taiwan. There are reports that some overseas workers are settling for lower pay/benefits to avoid lay-offs. Although full-year 2008 overseas workers' remittances expanded by 13.7% to a new record high $16.4 billion (10% of GDP), fourth quarter inflows slowed to 4.6% growth year-on-year and to only 1% growth in December. There are down-side risks to the government's current 6%-9% remittance growth projection for 2009, depending on evolving global developments, but officials currently see flat growth as the worst case scenario and remain confident that workers' remittances will muster some expansion this year due to the deployment of higher-skilled Filipinos.

Hefty Drop In Exports and Imports

¶6. (U) In December, total export revenue plunged a record 40.4%

year-on-year, led by a 47.6% year-on-year drop in receipts from electronics shipments (which contribute nearly two-thirds of annual Philippine exports). Full-year 2008 exports declined 2.9% from 2007, pulled down by a weak fourth quarter performance that saw October-December 2008 export receipts drop 22.5% and electronics exports decline by 27.7% from the third quarter of 2007. Low local-value-added (estimated at 30%) of electronics manufacturing here means that even this dramatic fall in exports has a less dire impact on the domestic economy.

¶7. (U) Cumulative January-November import payments increased 5.6% year-on-year, although the import bill dropped significantly year-on-year in October (11.1%) and plunged by 31.5% in November (the sharpest decline in over two decades - December figures are not yet available). Although weakening imports will temper balance of payments pressures from sputtering exports and investment flows, they signal weakening economic activity. Excluding oil/fuel (where price effects drove down imports), November 2008 import payments still fell by a steep 29% from November 2007, suggesting escalating uncertainties on business sentiment and local and external demand expectations. Imports of raw materials and intermediate inputs (down 32.8%) led the decline, with inputs for the electronics sector dropping by more than 50% year-on-year. November imports of capital equipment and consumer goods also declined by 29.3% and 6.7% year-on-year, respectively.

Emerging Pain for Tourism Industry

¶8. (U) Foreign tourist arrivals -- up 8.7% in 2007 - managed 1.5% growth to 3.1 million in 2008 despite the twin shocks of high oil prices and the global financial crisis. While January-July 2008 foreign visitor arrivals increased by more than 6% from 2007's comparable period, foreign visitors declined by low single-digits during the months of August, September and October; and, as the global financial crisis escalated, contracted by 12.3% in November and 6.5% in December (for a combined November-to-December decline of nearly 9% year-on-year). The Philippine national income accounts show that foreign demand for tourism-related services tumbled some 35% year-on-year in real terms during the second half of 2008 -- swamping the 7% real growth rate recorded during the first semester. Tourism services' share of full-year GDP declined from 3.4% in 2007

to 2.8% in 2008. Business people report that vacancy rates have doubled to around 40% in major hotels in Manila as businesses seek to save on travel expenses and conserve capital.

Softening Labor Market

¶9. (U) Pressures on the labor market have begun to emerge. According to Philippine Labor Department officials, businesses operating here have laid off some 40,000 workers since October 2008, while putting another 33,000 on shorter work hours. On January 30, the Labor Department issued guidelines on the adoption of flexible working arrangements (i.e., compressed workweeks, temporary reduction in workdays, rotation of workers, flexible holiday schedules, etc.) as a response to the global economic downturn. A number of bright spots remain, led by still promising employment prospects in the business process outsourcing industry, which expects to generate at least 100,000 new jobs this year. Citing findings from a recent international survey, an official from the Philippine office of a multinational recruitment company also told the press recently that many companies operating in the country currently still plan to hire at the managerial/professional levels and that firing rates are still relatively low -- better than the survey results in, among others, Singapore, China and India. Although net job creation may decline from the half million positions created in 2008 and exert upward pressure on employment and underemployment rates, many here still expect positive net job generation this year.

Further Policy Rates Cut and Deficit Spending

¶10. (U) For a second consecutive month, the Philippine Monetary Board (the Central Bank's policy-making body) cut interest rates by 50 basis points during its January 29 meeting -- a total reduction of 100 basis points since December. Officials hinted that decelerating inflation (7.1% in January 2009, a ten-month low) will provide room for further monetary easing. The Monetary Board -- which doubled resources for the Central Bank's rediscounting facility to 40 billion pesos ($850 million) last November -- further increased the rediscounting budget to 60 billion pesos ($1.3

billion) in mid-February.

¶11. (U) Department of Finance Secretary Margarito Teves also has hinted in a number of recent forums that the government may raise its programmed deficit ceiling even further from 1.2% of GDP -- to as much as 2% of GDP -- to prevent downward pressure on revenues from compressing the planned 14% year-on-year expansion in the 2009 budget.

¶12. (SBU) In January, the Economic Planning Department unveiled a 330 billion pesos (roughly $7 billion) "national resiliency program" stimulus package. Only some 40% of that amount actually represents new crisis-response commitments, and we assess that most of those commitments are smoke and mirrors rather than actual new outlays. Key presidential economic advisor Joey Salceda told EconCouns that he advised the President to "look like you are spending, but do not spend." In his view, the downturn is going to continue beyond 2009 and the GRP does not have the resources to have a noticeable impact on the downturn via fiscal policy, so it is better not to expend the resources on such an effort.

Comment

¶13. (SBU) Although the Philippines may be less affected than its more globally-integrated neighbors in the short-term, we remain concerned about the country's ability to post the strong post-crisis recovery needed to create jobs, attract investments, and ease poverty. Although we continue to monitor the unfolding impact of the global financial crisis closely, Post assistance efforts remain focused on helping the Philippines overcome longer-term challenges to achieving high, sustainable, and inclusive growth by, among others, improving competitiveness and reducing barriers to trade and

investment; improving revenue collection efficiency and public expenditure management; strengthening public sector institutions; and promoting transparency and good governance.

Kenney